

REPORT ON EXAMINATION
of the
HOSPITAL UNDERWRITING GROUP, INC.

RECEIVED

JUN 11 2004

Dept. Of Commerce & Insurance
Company Examinations

Nashville, Tennessee

as of

December 31, 2002

DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

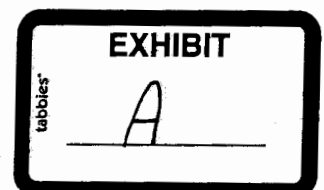


TABLE OF CONTENTS

INTRODUCTION	1
SCOPE OF EXAMINATION	2
COMPANY HISTORY	3
GROWTH OF COMPANY.....	5
CHARTER AND BYLAWS	5
MANAGEMENT AND CONTROL	6
HOLDING COMPANY SYSTEM	7
PECUNIARY INTEREST OF OFFICERS AND DIRECTORS.....	7
CORPORATE RECORDS.....	7
FIDELITY BOND AND OTHER INSURANCE	8
EMPLOYEE BENEFITS AND PENSION PLANS	9
TERRITORY AND PLAN OF OPERATION.....	9
MARKET CONDUCT ACTIVITIES	10
EXHIBIT OF PREMIUMS WRITTEN – SCHEDULE T	11
LOSS EXPERIENCE	11
REINSURANCE AGREEMENTS.....	12
AGREEMENTS WITH PARENT, SUBSIDIARIES AND AFFILIATES.....	12
LITIGATION AND CONTINGENT LIABILITIES	13
STATUTORY DEPOSITS	14
ACCOUNTS AND RECORDS.....	14
SUBSEQUENT EVENTS	15
FINANCIAL STATEMENTS.....	16
Assets.....	16
Liabilities, Surplus and Other Funds.....	17
Statement of Income.....	18
Capital and Surplus Account.....	19
ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION	20
ASSETS.....	20
Short-Term Investments.....	20
Federal Income Tax Recoverable.....	20
Interest, Dividends Due and Accrued	20
LIABILITIES, SURPLUS AND OTHER FUNDS	21
Other Expenses	21
Taxes, Licenses and Fees.....	21
Unearned Premiums	21
Total Surplus as Regards Policyholders	21
ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AS THEY AFFECT SURPLUS.....	23

COMMENTS AND RECOMMENDATIONS	24
Comments	24
Corporate Records	24
Fidelity Bond and Other Insurance	24
Reinsurance Agreements	24
Accounts and Records.....	24
Other Expenses	25
Taxes, Licenses and Fees.....	25
Unearned Premiums	25
Recommendations.....	26
Agreements with Parent, Subsidiaries and Affiliates.....	26
Short-Term Investments.....	26
Interest, Dividends Due and Accrued	26
Federal Income Tax Recoverable.....	26
Total Surplus as Regards Policyholders	27
CONCLUSION.....	28
EXAMINATION AFFIDAVIT	29
COMPANY ORGANIZATIONAL CHART	30

Nashville, Tennessee
April 26, 2004

The Honorable Alfred W. Gross
Chairman, NAIC Financial
Condition (E) Committee
Secretary, Southeastern Zone, NAIC
Virginia Bureau of Insurance
P. O. Box 1157
Richmond, Virginia 23218-1157

The Honorable Paula A. Flowers
Commissioner of Commerce & Insurance
State of Tennessee
500 James Robertson Parkway
Nashville, TN 37219

Commissioners:

Pursuant to your instructions and in accordance with the Tennessee Insurance Laws, regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination and a market conduct review was made of the conditions and affairs of the

HOSPITAL UNDERWRITING GROUP, INC.
NASHVILLE, TENNESSEE

hereinafter and generally referred to as the "Company."

INTRODUCTION

This examination was arranged by the Department of Commerce and Insurance of the State of Tennessee under rules promulgated by the NAIC. It was commenced on June 16, 2003, and was conducted by duly authorized representatives of the Department of Commerce and Insurance, State of Tennessee. Due to the Company writing business only in Tennessee, this examination is not classified as an Association examination and therefore was not called for any zone participation. This examination was made simultaneously with the Company's 100% owned subsidiary, Professional Liability Insurance Company (PLICO).

The previous examination was made as of December 31, 1997, by examiners of the State of Tennessee. Their report on examination contained some criticisms requiring corrective action by the Tennessee Department of Commerce and Insurance. The Company corrected all of the problems mentioned in the last report. See Comments - Previous Examination section included under Scope of Examination on page 2. All of the Company's original books and records are located at their home office in Nashville, Tennessee.

SCOPE OF EXAMINATION

This examination covers the period, January 1, 1998 through December 31, 2002, and includes any material transactions and /or events occurring subsequent to the examination date which were noted during the course of examination.

During the course of examination, assets were verified and valued, and liabilities were determined or estimated as of December 31, 2002, in accordance with rules and procedures as prescribed by the statutes of Tennessee, the Company's state of domicile. The examination of the financial condition was conducted in accordance with guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) Examiners Handbook.

A letter of representation, dated as of the date of this report and certifying that management has disclosed all significant matters and records, was obtained from management and has been included in the work papers of this report.

Comments - Previous Examination

The last financial condition examination as of December 31, 1997 did disclose a few regulatory concerns. There were two (2) recommendations listed in the previous examination report. The Company has corrected both of the following recommendations listed in the previous examination report.

1. The Company should value the common stock of its wholly owned subsidiary, Professional Liability Insurance Company, in accordance with the Department's interpretation of Tenn. Code Ann. § 56-1-405 by non admitting the value of special deposits for jurisdictions in which PLICO wrote no premium and by non admitting the difference between premiums written and the value of special deposits in jurisdictions where premiums written or reserves do not equal or exceed the value of those deposits.
2. The Company should account for the change in value in equity in affiliate through "Unassigned funds" in order to conform to Tenn. Code Ann. § 56-11-206 which defines surplus as "unassigned funds" for the calculation of "Extra Ordinary Dividends".

An examination of all assets and liabilities contained in the financial statement of this report was made and individual items were verified with a degree of emphasis determined by the examiner-in-charge during the planning stage of the examination. Independent actuaries were utilized in the review of the Company's loss reserves and loss adjustment expense reserves.

The Company is audited annually as part of the audit conducted for the holding company system, of which it is a member, by an independent accounting firm. The auditors' workpapers for the year ended 2002 were made available to the examiners during the planning phase of this examination. Workpapers of the auditors' substantive testing and their documentation of the

Company's procedures and verification of internal controls were relied upon where sufficient for the purposes of this examination. Copies of these workpapers are included in the examination files where appropriate.

An examination was also made into the following matters:

- Company History
- Growth of Company
- Charter and Bylaws
- Management and Control
- Holding Company System
- Pecuniary Interest of Officers and Directors
- Corporate Records
- Fidelity Bond and Other Insurance
- Employee Benefits and Pension Plans
- Territory and Plan of Operation
- Market Conduct Activities
- Exhibit of Premiums Written – Schedule T
- Loss Experience
- Reinsurance
- Commission Equity – Not Applicable for period of examination
- Agreements with Parent, Subsidiaries and Affiliates
- Litigation and Contingent Liabilities
- Statutory Deposit
- Accounts and Records
- Subsequent Events
- Financial Statements

These will be discussed as follows:

COMPANY HISTORY

The Company was incorporated as an association captive insurance company on February 16, 1979, according to the provisions of the Tennessee General Corporation Act and the Tennessee Captive Insurance Company Act with 40,000 authorized shares of capital stock at a par value of \$100 per share.

On April 30, 1976, Hospital Underwriting Group, Ltd. (HUG) was incorporated in Bermuda as a group captive insurance company by four (4) hospital management companies. HUG was organized to insure certain liability exposures of the owned and managed hospitals of these companies as shareholders of HUG. Pursuant to the provisions of an Agreement and Plan of

Reorganization dated February 26, 1979, by and between the Company and HUG, the assets and liabilities of HUG were transferred to the Company effective February 28, 1979, in exchange for 30,852 shares of the authorized capital stock of the Company.

Such shares were distributed by HUG to its shareholders on May 15, 1979, in complete liquidation and dissolution of HUG. These transactions were structured to qualify as a reorganization under the provisions of Section 368(a)(1) of the Internal Revenue Code of 1954.

Effective February 28, 1979, the Company was issued a Certificate of Authority by the Department of Commerce and Insurance, State of Tennessee, to write Professional Liability, Property, Casualty, Errors and Omissions, and Comprehensive General Liability. On December 16, 1985, HUG Services, Inc. was incorporated in the State of Delaware to act as a parent holding company under Tenn. Code Ann. § 56-13-102 (10) to qualify the Company as a "pure captive insurance company" under Tenn. Code Ann. § 56-13-102 (11). On December 19, 1985, HUG Services, Inc. acquired the shares outstanding of the Company, in exchange for a like number of shares of its stock.

A wholly-owned subsidiary, First Riverside Syndicate, Inc. (First Riverside), an underwriting member of the New York Insurance Exchange, was dissolved and combined into the Company as an operating division effective March 20, 1991. The Company assumed all of the assets and liabilities of First Riverside including the capital stock of Professional Liability Insurance Company (PLICO) which had previously been acquired by First Riverside on April 12, 1988. Therefore, 100% of the capital stock of PLICO is owned by the Company.

The Company's capital structure appears in the 2002 Annual Statement as follows:

Common capital stock	\$683,200
Gross paid in and contributed surplus	6,245,074
Unassigned funds (surplus)	<u>(1,602,223)</u>
Surplus as regards policyholders	<u>\$5,326,051</u>

Through June 1, 2002, the Company issued general hospital liability insurance policies. Policyholders are comprised of hospital management enterprises and holding companies which own the Company. Policies generally have limits of liability up to \$25 million per claim or occurrence and up to \$50 million in annual aggregate with deductibles that vary by policyholder. For losses in excess of the \$25 million per claim limit, the member hospitals have obtained an umbrella policy administered by the Company, from a third-party insurance company, with limits of \$75 million per claim or occurrence and with a \$75 million annual aggregate. Effective June 1, 2002, the Company discontinued underwriting any new policies. The Company will continue to maintain investments and loss reserves associated with existing insurance policies.

GROWTH OF COMPANY

The following exhibit depicts certain aspects of the growth and financial history of the Company for the period subject to this examination according to its annual statements as filed with the Department of Commerce and Insurance, State of Tennessee:

<u>Year</u>	<u>Premiums Earned</u>	<u>Losses Incurred</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
1998	\$9,927,360	\$10,813,002	\$111,936,726	\$97,298,537	\$14,638,189
1999	11,875,977	9,193,998	121,510,608	105,808,740	15,701,868
2000	9,571,424	8,843,119	107,570,257	88,002,752	19,567,505
2001	12,779,435	19,072,637	112,515,547	89,824,155	22,691,392
2002	23,556,022	50,018,206	91,470,723	86,144,672	5,326,051

CHARTER AND BYLAWS

The original Charter of the Company was approved by the Tennessee Insurance Commissioner and effected February 15, 1979. The Company had two (2) charter amendments in the early 1990's, which consisted of address changes. Other than these two amendments, the original charter remains unchanged.

The Charter provides for the operation of a Tennessee Captive Insurance Company that is for profit, and establishes its location in Nashville, Tennessee. The Charter in effect at the examination date states that, "The purpose for which the Corporation is organized is to make all types and forms of insurance permitted by the Tennessee Captive Insurance Company Act, now in existence or as it may be amended, on risks, hazards, and liabilities of the member organizations of its association and their parents and of the subsidiary companies, affiliated companies and/or associated companies of such member organizations and parents."

The Company's Charter states the shareholders shall have the power to elect directors, amend the charter, declare dividends, and change the nature of the business to be carried by the corporation. The Charter also states the bylaws of the corporation may be amended, repealed or adopted by the affirmative vote of the holders of two-thirds of the outstanding shares of capital stock of the corporation.

In addition to the above, the Company's Charter recites other general and specific powers in detail. They are usual in nature and consistent with statute.

The Bylaws of the Company in effect at December 31, 2002, were adopted by the shareholders on February 26, 1979. The Bylaws provide for an annual shareholders meeting at which a Board of Directors is elected. Officers are elected by the Board annually at the first Board meeting after the annual shareholders meeting. The Company's Bylaws have not been amended during the period of examination.

Prospective shareholders of the Company must be approved by the Board of Directors upon application and ratified by the existing shareholders. Applicants must be financially responsible, meet reasonable underwriting standards, and possess an insurable interest in such risks as the Company may propose to insure. Upon approval of an applicant by the Board of Directors and by the existing shareholders, such applicant must execute and become a party to the "Shareholders Agreement" with HUG Services, Inc.

Shareholders of the Company participate in the distribution of profits and net worth according to specific provisions as established in the Bylaws.

The current Bylaws are such as generally found in corporations of this type and contain no unusual provisions. They provide for the regulation of the business and for the conduct of the affairs of the Company, the directors and its shareholders.

MANAGEMENT AND CONTROL

The Company's Bylaws state that the business and affairs of the corporation shall be managed by a Board of Directors who shall be elected by the affirmative vote of three-quarters of the outstanding shares entitled to vote in the election at the annual meeting of the shareholders. The Company's Bylaws state that the number of directors shall be three or such greater number as the shareholders may from time to time determine. Directors serve until the next annual meeting of the shareholders and thereafter, until a successor has been elected.

The following persons were duly elected by the sole shareholder on June 7, 2002 and were serving as members of the Board at December 31, 2002:

Name

Sanford M. Bragman – Chairman of the Board

Tim Pullen

Robert Schwebel

Larry Cash

The Bylaws provide that the officers of the corporation shall be a president, a vice-president, a secretary and a treasurer. The corporation may also have additional vice-presidents, and one or more assistant secretaries and assistant treasurers.

At the Board of Directors Meeting on June 7, 2002, the following officers were duly elected and were serving at December 31, 2002:

<u>Name</u>	<u>Title</u>
Sanford M Bragman	Chairman of the Board and President
Horrace E. Gaddis, Jr.	Vice President – Operations and Secretary
James C. Oakley	Vice President and Treasurer
Mary Ellen Near	Assistant Secretary
Christy L. Collier	Assistant Secretary

HOLDING COMPANY SYSTEM

The Company, PLICO and its parent, HUG Services, Inc., are members of an insurance holding company system, as defined by Tenn. Code Ann. § 56-11-201, of which Tenet Healthcare Corporation is the ultimate parent. There are no persons that own in excess of 10% of the voting shares of Tenet Healthcare Corporation.

The Company is 100% owned by HUG Services, Inc., a Delaware corporation. HUG Services operates as an insurance holding company exclusively. As of December 31, 2002, Tenet Healthcare Corporation owned 92.5% of HUG Services, Inc. Community Health Systems owned the remaining 7.5% of the shares. Tenet Healthcare Corporation is a hospital organization located in California. In 2003, Tenet Healthcare Corporation purchased the remaining shares of HUG Services from Community Health Systems and now owns 100%. An organizational chart is attached to this report on page 30.

PECUNIARY INTEREST OF OFFICERS AND DIRECTORS

The Company has established a conflict of interest policy for its officers and directors. Directors, officers and certain employees are required to complete a Policy on Business Conduct Annual Questionnaire. This questionnaire is used for all entities within the holding company system and persons required to complete the certificate sign only one form regardless of the number of positions they hold with different companies throughout the system. The examiner reviewed the questionnaires completed by the Company's directors and major officers for the period under review with no exceptions.

CORPORATE RECORDS

The minutes of meetings of the Company's shareholders and Board of Directors meetings were reviewed for the period under examination. They were found to be well written and appear to properly reflect the acts of these respective bodies.

The Company, HUG Services, Inc. and PLICO's stockholders and Board of Directors all hold their meetings together and the minutes for each separate entity are commingled. Written consents and resolutions are done separately. Attendance by board members was 98% at these meetings.

However, one problem was noted during the review of the Company's corporate records. The Board of Directors did not approve the Company's actuary in any year during the exam period.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured under certain insurance coverages being carried by its parent, HUG Services, Inc.. The following is a summary of the various bonds and insurance policies that provided the enumerated coverages to the Company at December 31, 2002:

<u>Type of Coverage</u>	<u>Limits of Liability</u>
1. Commercial general liability	\$ 1,000,000 per occurrence \$ 100,000 fire limit-any one fire \$ 5,000 medical expense \$ 1,000,000 personal & advertising \$ 2,000,000 general aggregate \$ 2,000,000 products-completed operations
2. Workers compensation liability	Tennessee statutory limit
A. Workers compensation	
B. Employers liability	
a. Bodily injury by accident	\$ 100,000 each accident
b. Bodily injury by disease	\$ 100,000 each employee
c. Bodily injury by disease	\$ 500,000 policy limit

The Company does not maintain a fidelity bond. Minimum fidelity coverage suggested in the National Association of Insurance Commissioners' Examiners Handbook for a company of the Company's size and premium volume is not less than \$400,000. It is recommended that the Company obtain a fidelity bond of an amount in accordance with the NAIC suggested minimum.

The bonds and policies affording the aforementioned coverages were inspected and appear to be in-force as of the date of this examination. All of the above policies were issued by companies licensed to transact business in the State of Tennessee.

EMPLOYEE BENEFITS AND PENSION PLANS

As of December 31, 2002, the employees of the Company were eligible to participate in various benefit plans offered by the Company. The plans provided for term life, accidental death and dismemberment, long term disability, cancer insurance, comprehensive medical and dental coverages.

The Company and its subsidiary, Professional Liability Insurance Company, participate in a 401(k) deferred compensation plan covering substantially all employees. The Company matches 100% of each employee's contribution up to 5% of annual salary. Employees participating at the plan's inception are fully vested in all contributions. Employees added to the plan subsequent to its inception vest 20% annually in the employer's matching contribution.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2002, and as of the date of this examination report, the Company was licensed to transact business in the State of Tennessee. The Certificate of Authority for this jurisdiction was reviewed.

Plan of Operation

Through June 1, 2002, the Company issued comprehensive general liability insurance including employers liability and hospital professional liability insurance on owned and managed hospitals of its shareholders and their subsidiaries, affiliated companies, and associated companies. Policyholders are comprised of hospital management enterprises and holding companies which own the Company. Policies generally have limits of liability up to \$25 million per claim or occurrence and up to \$50 million in annual aggregate with deductibles that vary by policyholder. For losses in excess of the \$25 million per claim limit, the member hospitals have obtained an umbrella policy administered by the Company, from a third-party insurance company, with limits of \$75 million per claim or occurrence and with a \$75 million annual aggregate.

Effective June 1, 2002, the Company ceased writing its main line of business (Hospital Professional Liability and General Liability coverages for members). The Company has continued to write a small amount of premiums (approximately \$350,000 net) for Tenet Healthcare Corporation. These policies consist primarily of first dollar coverage for medical malpractice coverage for one hospital, connected with its operation as a trauma center.

For all practical purposes, the Company is now in run-off. Additionally, the Company states that there are no plans to write any additional business in the near future.

The policy form in use by the Company at December 31, 2002, provides for an initial premium and additional retrospective premiums, if necessary, all of which are applicable to the annual policy term.

The initial premium is calculated by actuarial methods using modified bed equivalent rates which differentiate the costs of insuring exposures (births, surgeries, etc.) located in various states and in urban areas with higher claims frequencies. Retrospective premiums consist of a general experience modifier less than or equal to one hundred percent (100%) of the initial premium. The general experience modifier may be applied in whole or in part by the Board of Directors with respect to all insured members whose losses and allocated share of general expenses exceed the sum of their initial premiums during any policy year. However, the aggregate retrospective premiums which may be applied cannot exceed one hundred percent (100%) of the initial premium.

The Bylaws of the Company are structured to promote shareholder participation in its investment earnings and underwriting profits. Each shareholder is designated a capital account and an insurance account for each policy year. Earnings from the investment of capital are credited to each shareholder's capital account. Profits, if any, from underwriting and the investment of premiums attributable to each policy year are shared in proportion to initial premiums paid by each insured for that year and are credited to each respective insured's insurance account. The declaration of distributions from the shareholder/insured accounts is at the discretion of the Board of Directors according to specific rules as stated in the Bylaws.

MARKET CONDUCT ACTIVITIES

In accordance with the policy of the Department of Commerce and Insurance, State of Tennessee, a market conduct review was made of the Company as of December 31, 2002 in conjunction with this examination. The following items were addressed:

Policy Forms, Rating and Underwriting:

Under Tenn. Code Ann. § 56-13-123, policy forms are filed with the Department only if the Commissioner deems necessary. The Company has never been required to file any policy forms in the past. All policy forms used during the period of examination were reviewed.

Under Tenn. Code Ann. § 56-13-125, rates are filed with the Department only if the Commissioner deems necessary. The Company has never been required to file any rates in the past. Policies were reviewed to application files and underwriting standards.

Advertising:

As a captive insurer, the Company has only affiliated policyholders, therefore, the Company does not do any advertising.

Policyholder Complaints:

Inquiries made to the various policyholders service offices and the NAIC market conduct database indicated no concerns or complaints with the Company during the period under examination.

Claims Review:

The examination included a review of the Company's claims handling to determine compliance with Tenn. Code Ann. § 56-8, Part 1. A review of open claims at December 31, 2002 and subsequent revealed that the Company appears to be setting reserves on a consistent basis. Closed claims during the period of examination were reviewed and indicated that claims were being paid in accordance with policy provisions and settlements were made promptly upon receipt of proper evidence of the Company's liability.

EXHIBIT OF PREMIUMS WRITTEN – SCH. T

<u>State</u>	<u>Direct Premiums Written</u>	<u>Direct Premiums Earned</u>	<u>Direct Losses Paid</u>	<u>Direct Losses Unpaid</u>
Tennessee	\$22,775,967	\$31,822,874	\$68,471,182	\$102,686,842
Totals	\$22,775,967	\$31,822,874	\$68,471,182	\$102,686,842

LOSS EXPERIENCE

As developed from applicable amounts included in the Company's annual statements filed with the Department of Commerce and Insurance for the State of Tennessee, the ratios of losses and loss adjustment expenses (LAE) incurred to earned premiums for the period subject to this examination were as follows:

<u>Year</u>	<u>Losses & LAE</u>		<u>Loss Ratio</u>
	<u>Incurred</u>	<u>Earned Premiums</u>	
1998	\$11,602,325	\$9,927,360	116.87%
1999	9,897,268	11,875,977	83.34%
2000	9,078,240	9,571,424	94.85%
2001	19,462,684	12,779,435	152.30%
2002	50,997,534	23,556,022	216.49%
Total All Years	\$101,038,051	\$67,710,218	149.20%

REINSURANCE AGREEMENTS

Reinsurance Ceded:

On June 1, 2001, the Company entered into a Aggregate Excess of Loss Reinsurance Agreement negotiated through Aon Re Inc. with Employers Reinsurance Corporation, Odyssey Reinsurance Corporation, Hannover Ruckversicherungs-Aktiengesellschaft, Terra Nova Insurance Company Limited and Zurich Re Insurance Company covering all business classified by the Company as hospital professional liability (including employed physicians professional liability), comprehensive general liability, contractual liability, druggists liability, employers liability, personal injury liability, managed care liability including errors and omissions liability, employment practices liability and miscellaneous professional liability.

This agreement applies to all losses occurring and/or claims made on policies written or renewed with effective dates on or after June 1, 2001. Layer A covers one hundred percent (100%) of \$2,000,000 excess of \$3,000,000 per claim. Layer B covers one hundred percent (100%) of \$5,000,000 excess of \$5,000,000 per claim. Layer C covers one hundred percent (100%) of \$15,000,000 excess of \$10,000,000 per claim.

Employers Reinsurance Corporation, Odyssey Reinsurance Corporation, Hannover Ruckversicherungs-Aktiengesellschaft, and Terra Nova Insurance Company Limited are all authorized reinsurers in the State of Tennessee. However, Zurich Re Insurance Company is an unauthorized reinsurer in the State of Tennessee. The Company has been incorrectly listing Zurich Re as an authorized reinsurer in the last two (2) filed Annual Statements. The Company should correct this error in all future financial statement filings. The Company has one (1) letter of credit with all of its reinsurers, including Zurich Re, in the amount of \$535,650, which allows the Company to receive the reinsurance credit on the premiums ceded to Zurich Re.

The contract did not require prior approval per Tenn. Code Ann. Also, the contract contains a standard insolvency clause.

AGREEMENTS WITH PARENT, SUBSIDIARIES AND AFFILIATES

The Company had two (2) agreements with affiliated companies in effect as of December 31, 2002. The following are summaries of the agreements in effect as of this examination for the Company:

Management Service Agreement:

Effective December 1, 1988, the Company entered into a Management Service Agreement with its subsidiary, Professional Liability Insurance Company (PLICO). According to the terms and provisions of the Contract, the Company agrees to provide PLICO with certain administrative

services for its internal operations and processing its insurance business. Such services include general administration, claims handling, computer services, premium billing, policyholder services, investments and relations with regulatory authorities.

PLICO has no employees of its own. All services necessary to its business are provided by the Company pursuant to the Contract. PLICO pays the Company a fee based on a stated formula each month for these services. Transactions under the Management Service Agreement were reviewed for compliance with the Contract and charges appear to be commensurate with services rendered.

This agreement has never been filed for approval by the Commissioner of Insurance as required by Tenn. Code Ann. § 56-11-206 (2)(A). It is recommended that the Company comply with Tenn. Code Ann. § 56-11-206 (2)(A) and file this management service agreement with the Tennessee Department of Commerce and Insurance for their approval.

Tax Sharing Agreement:

This agreement between HUG Services, Inc. and the Company was adopted effective as of July 29, 1998. This agreement was amended from a prior tax sharing agreement performed in 1988.

The agreement states the two parties elect to allocate their tax liability during consolidated return years by the method defined in section 1504 of the Internal Revenue Code. The consolidated tax liability is allocated to each member of the consolidated group based upon the percentage of each member's tax computed on a separate return basis to the total tax so computed for all members. In lieu of actual payments, adjustments to intercompany payable and receivables will be made if such exist on the Company's books. Transactions under the Tax Sharing Agreement were reviewed for compliance with the Contract with no exceptions.

This agreement has been disclosed by the Company in its Holding Company Registration Statement in each year for the period under review.

LITIGATION AND CONTINGENT LIABILITIES

From the data made available during the progress of this examination, it would appear that the only matters at law in which the Company was involved, during the period under review, were those relating to the settlement of claims.

The Company also apparently had no agreements or pending matters of contingent nature that would materially affect its financial position or operating results at December 31, 2002.

STATUTORY DEPOSIT

In compliance with statutory and other requirements, the Company maintained the following deposit with the named jurisdiction or custodian as of December 31, 2002:

<u>Jurisdiction</u>	<u>Description of Security</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Market Value</u>
Tennessee - Dept. of Insurance	US Treasury Note 4.75%, Due 11-15-08 Cusip # 912828-AJ-9	<u>\$750,000</u>	<u>\$762,384</u>	<u>\$818,670</u>
Total		<u>\$750,000</u>	<u>\$762,384</u>	<u>\$818,670</u>

The security deposited with the Tennessee Department of Commerce and Insurance was held for the benefit of all policyholders, claimants and creditors of the Company. Deposit with said jurisdiction or custodian was verified by direct correspondence with the custodian of such deposit.

ACCOUNTS AND RECORDS

During the course of the examination, accounts were verified by various tests and procedures deemed necessary to establish values for assets and liabilities appearing in the Company's financial statements. Test checks, for selected periods, were made of premium receipts, investment income, interest due and accrued, claim payments, and other disbursements. All annual statements for the period under examination were reviewed for completeness and adequacy of disclosure. The Company's risk-based capital filings were reviewed and sample tested for correctness. These test checks and reviews revealed no material discrepancies.

However, during the examination the following accounts and records deficiency was noted. The number of common stock shares owned in its subsidiary, PLICO, has been incorrectly reported in Schedule D – Part 2 – Section 2 of the Company's Annual Statement filings for the period under review. This should be corrected in all future filings.

SUBSEQUENT EVENTS

Due to the Company having an extremely negative underwriting year in 2002, their total surplus as regards policyholders had fallen to \$5,326,051 as reported by them in their 2002 Annual Statement. After examination adjustments for this exam were finalized, we stated the Company's total surplus (not including capital) as of December 31, 2002 to be (\$1,086,134). This is well below the stated \$350,000 minimum for surplus as required by Tenn. Code Ann. § 56-13-116 for captive insurance companies.

In February 2003, the Company assessed and collected retroactive premiums of \$15 million. The assessment and collection of this retroactive premium adjustment has restored the Company's surplus level above the statutory minimum subsequent to December 31, 2002. However, it is recommended that the Company maintain compliance with Tenn. Code Ann. § 56-13-116 at all times.

Financial Statement

There follows a statement of assets, liabilities and a summary of operations as of December 31, 2002, together with a reconciliation of capital and surplus for the period under review, as established by this examination.

	<u>Assets</u>			
	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Non-Admitted Assets</u>	<u>Net-Admitted Assets</u>
Bonds	\$50,402,275			\$50,402,275
Common stocks	4,063,507			4,063,507
Cash on hand and on deposit	(12,596,207)			(12,596,207)
Short-term investments	25,273,091		965,030	24,308,061
Premium installments booked but deferred and not yet due	296,551			296,551
Reinsurance recoverables on loss and loss adjustment expense payments	15,186,017			15,186,017
Federal income tax recoverable and interest thereon	7,875,794		4,338,650	3,537,144
Interest, dividends and real estate income due and accrued	969,695		398,923	570,772
	<u>969,695</u>	<u></u>	<u>398,923</u>	<u>570,772</u>
Totals	<u>\$91,470,723</u>	<u>\$0</u>	<u>\$5,702,603</u>	<u>\$85,768,120</u>

Liabilities, Surplus and Other Funds

Losses		\$80,640,888
Loss adjustment expenses		5,081,538
Other expenses		32,992
Taxes, licenses and fees		260,140
Unearned premiums		<u>155,496</u>
Total Liabilities		\$86,171,054
Common capital stock	\$683,200	
Gross paid in and contributed surplus	6,245,074	
Unassigned funds (surplus)	<u>(7,331,208)</u>	
Total Surplus as Regards Policyholders		<u>(402,934)</u>
Totals		<u><u>\$85,768,120</u></u>

Statement of Income

UNDERWRITING INCOME:

Premiums earned		\$23,556,022
Losses incurred	\$50,018,206	
Loss expenses incurred	979,328	
Other underwriting expenses incurred	<u>1,207,009</u>	
Total underwriting deductions		<u>52,204,543</u>
Net Underwriting Gain or (Loss)		(\$28,648,521)

INVESTMENT INCOME:

Net investment income earned	\$3,181,195	
Net realized capital gains or (losses)	<u>2,373,955</u>	
Net Investment Gain or (Loss)		<u>5,555,150</u>

Net income before dividends to policyholders and before federal and foreign income taxes		(\$23,093,371)
Dividends to policyholders		<u>0</u>
Net income, after dividends to policyholders but before federal and foreign income taxes		(\$23,093,371)
Federal and foreign income taxes incurred		<u>(7,851,745)</u>
Net Income		<u>(\$15,241,626)</u>

Capital and Surplus Account

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Total Surplus as Regards Policyholders December 31, previous year	\$14,920,333	\$14,638,189	\$15,701,868	\$19,567,505	\$22,691,392
Net income or (loss)	\$2,344,520	\$950,475	\$4,600,116	\$244,596	(\$15,241,626)
Net unrealized capital gains or (losses)	(1,487,400)	67,773	(777,487)	891,676	(45,894)
Change in non-admitted assets	(22,540)	13,601	11,164	30,865	(5,682,949)
Change in net deferred income tax	0	0	0	1,956,750	(2,123,857)
Capital changes:					
Paid-in	(353,000)	0	6,148,800	0	0
Transferred from surplus (stock dividend)	0	0	(6,148,800)	0	0
Surplus adjustments:					
Paid-in	(20,098)	0	0	0	0
Dividends to stockholders	(559,404)	0	0	0	0
Aggregate write-ins for gains and losses in surplus	(184,222)	31,830	31,844	0	0
Change in total surplus as regards policyholders for the year	(\$282,144)	\$1,063,679	\$3,865,637	\$3,123,887	(\$23,094,326)
Total Surplus as Regards Policyholders December 31, current year	\$14,638,189	\$15,701,868	\$19,567,505	\$22,691,392	(\$402,934)

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION

ASSETS

Short Term Investments: \$24,308,061

The amount shown above is \$965,030 less than what was reported by the Company in its 2002 Annual Statement (A/S). **REASON:** The Company has one short-term US Treasury Note that has been tied up in a litigation matter since the late 1980's. It was originally a deposit so that the Company could be a member of the New York Insurance Exchange. That exchange went bankrupt in the late 1980's, and because of that, all of the deposits were held in a pool to cover losses. The Company valued the deposit as a short-term investment for \$965,030 in their 2002 A/S. Tenn. Code Ann. § 56-1-405 states monies must be available for the payment of claims in order to be admitted assets. Due to the Company not having control of the deposit, it will be non-admitted due to Tenn. Code Ann. § 56-1-405. It is recommended that the Company comply with Tenn. Code Ann. § 56-1-405 concerning the admittance of assets.

Federal Income Tax Recoverable: \$3,537,144

The amount shown above is \$4,338,650 less than what was reported by the Company in its 2002 Annual Statement. **REASON:** This was based on a recalculation of deferred tax assets upon guidance from NAIC's Accounting Practices and Procedures SSAP #10 concerning a limitation up to a maximum of 10% of statutory capital and surplus from the statutory balance sheet for its most recent statement (9/30/02) filed with the Department of Commerce & Insurance. This recalculation resulted in the non-admission of \$4,338,650 of deferred tax assets. It is recommended that the Company follow guidance from the NAIC Accounting Practices and Procedures Manual concerning the reporting of Federal Income Tax asset and liability amounts.

Interest, Dividends Due and Accrued: \$570,772

The amount shown above is \$398,923 less than what was reported by the Company in its 2002 Annual Statement. **REASON:** This amount is the combination of two figures: (1) \$323,923 is the total accrued interest on the short-term US Treasury Note that is being non-admitted for our examination described above. Therefore, it to will be non-admitted. (2) The Company included \$75,000 in this item that was accrued interest on PLICO's surplus note, however, they had already received this payment. Therefore, it will be non-admitted.

LIABILITIES, SURPLUS AND OTHER FUNDS

Other Expenses: \$32,992

The amount shown above is \$32,992 more than what was reported by the Company in its 2002 Annual Statement. **REASON:** The Company did not accrue any amounts for other expenses, however, in our review we found \$32,992 that should have been accrued.

Taxes, Licenses and Fees: \$260,140

The amount shown above is \$260,140 more than what was reported by the Company in its 2002 Annual Statement. **REASON:** The Company did not accrue any amounts for taxes, licenses and fees; however, in our review we found \$260,140 that should have been accrued.

Unearned Premiums: \$155,496

The amount shown above is \$266,750 less than what was reported by the Company in its 2002 Annual Statement. **REASON:** In our review of the Company's amount, we noted that \$266,750 of the item's balance was actually unamortized reinsurance premiums and not unearned premiums. Therefore, we lowered unearned premiums by that amount and adjusted surplus accordingly.

Total Surplus as Regards Policyholders: (\$402,934)

Total Surplus as Regards Policyholders as established by this examination is \$5,728,985 less than what was reported by the Company in its December 31, 2002 Annual Statement. For this examination, we decreased short-term investments by \$965,030, decreased federal income tax recoverable by \$4,338,650, decreased interest, dividends due and accrued by \$398,923, increased other expenses by \$32,992, increased taxes, licenses and fees by \$260,140, and decreased unearned premiums by \$266,750. These amounts are outlined in the subsequent schedule which indicates changes in the financial statement as they affect surplus. The changes in these items are discussed in detail under the appropriate caption elsewhere in this report.

After examination adjustments for this exam were finalized, we stated the Company's total surplus (not including capital) as of December 31, 2002 to be (\$1,086,134). This is well below the stated \$350,000 minimum for surplus as required by Tenn. Code Ann. § 56-13-116 for captive insurance companies.

In February 2003, the Company assessed and collected retroactive premiums of \$15 million. The assessment and collection of this retroactive premium adjustment has restored the Company's surplus level above the statutory minimum subsequent to December 31, 2002. However, it is recommended that the Company maintain compliance with Tenn. Code Ann. § 56-13-116 at all times.

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AS THEY AFFECT SURPLUS

<u>Item</u>	<u>Reclassification</u>	<u>Increase</u>	<u>Decrease</u>	<u>Surplus</u>
Total Surplus as Regards Policyholders per Company				\$5,326,051
Short-Term Investments			\$965,030	
Federal Income Tax Recoverable			4,338,650	
Interest, Dividends Due and Accrued			398,923	
Other Expenses			32,992	
Taxes, Licenses and Fees			260,140	
Unearned Premiums		\$266,750		
		<u>\$266,750</u>	<u>\$5,995,735</u>	
Totals	\$0	\$266,750	\$5,995,735	
Total Decrease per Examination				<u>(5,728,985)</u>
Total Surplus as Regards Policyholders per Examination				<u>(\$402,934)</u>

COMMENTS AND RECOMMENDATIONS

The following list presents a summary of comments and recommendations noted in this report:

Comments:

1. Corporate Records - Page 7

The minutes of meetings of the Company's shareholders and Board of Directors meetings were reviewed for the period under examination. They were found to be well written and appear to properly reflect the acts of these respective bodies.

The Company, HUG Services, Inc. and PLICO's stockholders and Board of Directors all hold their meetings together and the minutes for each separate entity are commingled. Written consents and resolutions are done separately.

However, one problem was noted during the review of the Company's corporate records. The Board of Directors did not approve the Company's actuary in any year during the exam period.

2. Fidelity Bond and Other Insurance – Page 8

The Company does not maintain a fidelity bond. Minimum fidelity coverage suggested in the National Association of Insurance Commissioners' Examiners Handbook for a company of the Company's size and premium volume is not less than \$400,000. It is recommended that the Company obtain a fidelity bond of an amount in accordance with the NAIC suggested minimum.

3. Reinsurance Agreements – Page 12

Zurich Re Insurance Company is an unauthorized reinsurer in the State of Tennessee. The Company has been incorrectly listing Zurich Re as an authorized reinsurer in the last two (2) filed Annual Statements. The Company should correct this error in all future financial statement filings.

4. Accounts and Records – Page 14

During the examination the following accounts and records deficiency was noted. The number of common stock shares owned in its subsidiary, PLICO, has been incorrectly reported in Schedule D – Part 2 – Section 2 of the Company's Annual Statement filings for the period under review. This should be corrected in all future filings.

5. Other Expenses – Page 21

Other Expenses was increased by \$32,992 for this examination. The Company did not accrue any amounts for other expenses, however, in our review we found \$32,992 that should have been accrued.

6. Taxes, Licenses and Fees – Page 21

Taxes, Licenses and Fees were increased by \$260,140 for this examination. The Company did not accrue any amounts for taxes, licenses and fees; however, in our review we found \$260,140 that should have been accrued.

7. Unearned Premiums – Page 21

Unearned Premiums were reduced by \$266,750 for this examination. In our review of the Company's amount, we noted that \$266,750 of the item's balance was actually unamortized reinsurance premiums and not unearned premiums. Therefore, we lowered unearned premiums by that amount and adjusted surplus accordingly.

Recommendations:

1. Agreements with Parent, Subsidiaries and Affiliates – Page 12

Effective December 1, 1988, the Company entered into a Management Service Agreement with its subsidiary, PLICO. This agreement has never been filed for approval by the Commissioner of Insurance as required by Tenn. Code Ann. § 56-11-206 (2)(A). It is recommended that the Company comply with Tenn. Code Ann. § 56-11-206 (2)(A) and file this management service agreement with the Tennessee Department of Commerce and Insurance for their approval.

2. Short Term Investments – Page 20

The Company has one short-term US Treasury Note that has been tied up in a litigation matter since the late 1980's. It was originally a deposit so that the Company could be a member of the New York Insurance Exchange. That exchange went bankrupt in the late 1980's, and because of that, all of the deposits were held in a pool to cover losses. The Company valued the deposit as a short-term investment for \$965,030 in their 2002 Annual Statement. Tenn. Code Ann. § 56-1-405 states monies must be available for the payment of claims in order to be admitted assets. Due to the Company not having control of the deposit, it will be non-admitted due to Tenn. Code Ann. § 56-1-405. It is recommended that the Company comply with Tenn. Code Ann. § 56-1-405 concerning the admittance of assets.

3. Interest, Dividends Due and Accrued – Page 20

Interest, dividends due and accrued was reduced by \$398,923 for this examination. This amount is the combination of two figures: (1) \$323,923 is the total accrued interest on the short-term US Treasury Note that is being non-admitted for our examination described above. Therefore, it to will be non-admitted. (2) The Company included \$75,000 in this item that was accrued interest on PLICO's surplus note, however, they had already received this payment. Therefore, it will be non-admitted. It is recommended that the Company comply with Tenn. Code Ann. § 56-1-405 concerning the admittance of assets.

4. Federal Income Tax Recoverable – Page 20

Federal Income Tax Recoverable was reduced by \$4,338,650 for this examination. This was based on a recalculation of deferred tax assets upon guidance from NAIC's Accounting Practices and Procedures SSAP #10 concerning a limitation up to a maximum of 10% of statutory capital and surplus from the statutory balance sheet for its most recent statement (9/30/02) filed with the Department of Commerce & Insurance. This recalculation resulted in the non-admission of \$4,338,650 of deferred tax assets. It is recommended that the Company follow guidance from the NAIC Accounting Practices and Procedures Manual concerning the reporting of Federal Income Tax asset and liability amounts.

5. Total Surplus as Regards Policyholders – Page 21

After examination adjustments for this exam were finalized, we stated the Company's total surplus (not including capital) as of December 31, 2002 to be (\$1,086,134). This is well below the stated \$350,000 minimum for surplus as required by Tenn. Code Ann. § 56-13-116 for captive insurance companies.

In February 2003, the Company assessed and collected retroactive premiums of \$15 million. The assessment and collection of this retroactive premium adjustment has restored the Company's surplus level above the statutory minimum subsequent to December 31, 2002. However, it is recommended that the Company maintain compliance with Tenn. Code Ann. § 56-13-116 at all times.

CONCLUSION

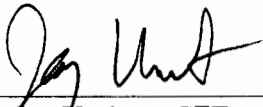
The customary insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of Hospital Underwriting Group, Inc. of Nashville, Tennessee.

In such manner, it was found that as of December 31, 2002, the Company had admitted assets of \$85,768,120 and liabilities, exclusive of surplus, of \$86,171,054. Thus, there existed for the additional protection of the policyholders, the amount of (\$402,934) in the form of common capital stock, gross paid in and contributed surplus and unassigned funds. In February 2003, the Company assessed and collected retroactive premiums which have restored the Company's surplus level above the statutory minimum.

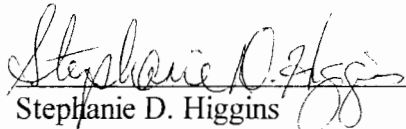
The courteous cooperation of the officers and employees of the Company, extended during the course of the examination, is hereby acknowledged.

In addition to the undersigned, Brett E. Miller, FCAS, MAAA, FCA, contract actuary for the State of Tennessee, participated in the work of this examination.

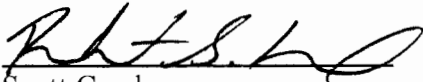
Respectfully submitted,



A. Jay Uselton, CFE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC



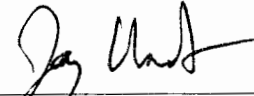
Stephanie D. Higgins
Insurance Examiner, CFE
State of Tennessee
Southeastern Zone, NAIC



Scott Creel
Insurance Examiner, II
State of Tennessee
Southeastern Zone, NAIC

EXAMINATION AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Hospital Underwriting Group, Inc. of Nashville, Tennessee dated April 26, 2004, and made as of December 31, 2002, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and the facts therein set forth are true to the best of his knowledge, information and belief.



A. Jay Uselton, CFE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

County Davidson

State Tennessee

Subscribed and sworn to before me
this 26th day of
April, 2004

Helen W. Dorsey
(NOTARY)

My Commission Expires

March 25, 2006

ORGANIZATIONAL CHART
As of December 31, 2002

In early 2003, Tenet Healthcare Corporation purchased the remaining shares of HUG Services, Inc. from Community Health Systems and now owns 100%.

